IN THE

Supreme Court of the United States

October Term, 1946. 1947

No. 146

ARTHUR D. SCHULTE, JOHN S. SCHULTE AND DAVID A. SCHULTE, JR., as Trustees under a trust agreement dated June 3, 1932, made by David A. Schulte, as Grantor,

Petitioners,

against

PARK & TILFORD, INC.,

Respondent,

UNITED STATES OF AMERICA,

Intervenor-Respondent,

MARJORIE D. KOGAN, on her own behalf and on behalf of all other stockholders of Park & Tilford, Inc. similarly situated, and in the right of Park & Tilford, Inc.,

Intervenor-Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

EDWIN A. FALK,
MURRAY C. BERNAYS,
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Intervenor-Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT[1]

Your petitioners, Arthur D. Schulte, John S. Schulte and David A. Schulte, Jr., as Trustees as hereinabove set forth, respectfully pray that a writ of certiorari issue

[1] It is believed that the argument in support of the petitioners' contentions is sufficiently set out in the Reasons Relied on for Granting the Writ, pp. 6-16, *infra*. Accordingly, no separate brief is being filed.

to review the judgment of the Circuit Court of Appeals for the Second Circuit, rendered January 8, 1947, which vacated a judgment of the United States District Court for the Southern District of New York against the petitioners and in favor of the respondent, Park & Tilford, Inc., in the sum of $302,145.81, together with interest and costs, and remanded the action to the District Court for the award of a judgment against your petitioners and in favor of said respondent for $418,128.59, with interest and costs.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered January 8, 1947 (R. 122). Rehearing was denied by order entered March 26, 1947 (R. 148). The jurisdiction of the District Court is founded on the provisions of §27 of the Securities Exchange Act of 1934, 48 Stat. 902, Title 15 U. S. C. §78aa. The jurisdiction of this Court rests upon §240(a) of the Judicial Code as amended by the Act of February 13, 1925 [Title 28, U. S. C. §347a].

Opinions Below

The opinion of the District Court is printed at R. 85. Its Findings and Conclusions appear at R. 78-82.

The opinion of the Circuit Court of Appeals is reported in 160 F. (2d) 984 and is also printed in the record (R. 117). The majority opinion of the Circuit Court of Appeals denying petition for rehearing with respect to the amount of the judgment, and the minority opinion in favor of rehearing, are reported in 160 F. (2d) 989, and are printed in the record at R. 142-7.

Questions Presented

1. Whether a conversion of preferred into common stock, followed by a sale within six months, is a "purchase and sale" within the statutory language of §16(b) of the Securities Exchange Act of 1934, Title 15 U. S. C. §78p(b), where the preferred stock, which had been owned continuously by the petitioners since December, 1937, was made convertible into common stock by the provisions of the certificate of incorporation authorizing the issue thereof, and such conversion into common stock occurred in January, 1944, followed by sales within six months thereafter.

2. Whether such a transaction, even if it be deemed a "purchase" under §16(b), comes within the exception which provides that the section does not apply when "such security was acquired in good faith in connection with a debt previously contracted."

3. Whether §16(b) of the Securities Exchange Act of 1934, if construed to include the transaction at bar, would be valid under the due process and interstate commerce clauses of the United States Constitution.

Statute Involved

Pertinent provisions of the Securities Exchange Act of 1934 (48 Stat. 881, 15 U. S. C. §§78a *et seq.*) are set forth in Appendix A hereto, pp. 17-19, *infra.*

Summary Statement

The petitioners are Trustees under an irrevocable trust agreement dated June 3, 1932, made by their father, David A. Schulte, as grantor. The respondent Park & Tilford, Inc. is a Delaware corporation whose common stock is registered on the New York Stock Exchange. The intervenor Kogan owns 25 shares of the common

stock of Park & Tilford, Inc., which she says she acquired on or about March 10, 1945. The United States of America was permitted to intervene because the petitioners' amended answer put in issue the constitutionality of the statute as sought to be applied to the transaction at bar.

On July 22, 1937 Park & Tilford, Inc. amended its certificate of incorporation and created a class of convertible preferred stock known as "6% Cumulative Preferred Stock" of the par value of $50 per share. This stock was subject to redemption, at $55 per share plus accrued dividends, at the option of the company's board of directors, at any time upon 90 days' notice of such redemption. The holders of such preferred stock had the right to convert each share into 1¼ shares of common stock, and this right of conversion was to continue after notice of redemption but to cease and terminate upon such date as might be fixed for redemption.

In December, 1937 petitioners became the registered owners of 6,604 shares of this preferred stock, which they continuously owned until January 19, 1944.

On November 29, 1943 the board of directors of Park & Tilford, Inc. elected to redeem, on March 20, 1944, all the then outstanding preferred stock at the rate of $55 per share plus accrued and unpaid dividends to the redemption date.

The formal notice of this action was received by the petitioners on or about December 20, 1943. On January 19, 1944 the petitioners elected to convert their preferred into common, and received for such preferred stock 8,255 shares of common stock.[2] The petitioners sold in excess

[2] This course gave the trust the greater of the two available values for its preferred. On March 20, 1944 the redemption price of the preferred, including accrued dividends in full to that date, would have been $55.75 per share. On January 19, 1944, the date on which the petitioners converted their preferred into common, the latter had a market value of $58.25 per share, so that by conversion the petitioners received, for each share of preferred, shares of common having a market value of $72.81 (1¼ times $58.25).

of this number of shares of common, in the administration of the trust, within six months after the date of conversion.

The courts below have held (1) that the petitioners' conversion of their preferred stock into common, and the subsequent sales of common within six months, are a "purchase and sale" within the statutory language of §16(b); (2) that the transaction was not one wherein the common stock "was acquired in good faith in connection with a debt previously contracted"; and (3) that the statute, in its application to such a transaction, is constitutional.

These are the sole questions presented by the instant application.

Specification of Errors To Be Urged

The Circuit Court of Appeals erred as follows:

1. In holding that the petitioners' conversion of the preferred stock into common constituted a "purchase" of the common stock within the meaning of §16(b) of the Securities Exchange Act of 1934.

2. In holding that the acquisition of the common stock by the petitioners, even if it be deemed a "purchase" within §16(b), did not come within the exception which takes out of the application of the section a transaction wherein "such security was acquired in good faith in connection with a debt previously contracted."

3. In holding that §16(b), if construed to include the transaction at bar, is constitutional.

REASONS RELIED ON FOR GRANTING THE WRIT

I

The Court below has decided important questions of Federal law which have not been, but should be, settled by this Court.

The question whether a conversion of preferred stock into common, pursuant to provision therefor in the certificate of incorporation authorizing the issuance of such preferred stock, is a "purchase" within the language of §16(b), has not been passed upon by this Court. Outside the instant case it has never been passed upon by any other court.[3] It is a question of fundamental and widespread importance, governing accountability under §16(b) of the Act in all the situations in which there are outstanding convertible corporate securities.[4]

Nor has this Court, or any other court except in the instant case, ever passed upon the question whether such a transaction as the one in suit, even if it be deemed a "purchase", comes within the exception whereby the provisions of §16(b) do not apply when "such security was acquired in good faith in connection with a debt previously contracted."

Equally important is it, to have authoritatively determined the question whether §16(b), in its application

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[3] *Smolowe* v. *Delendo Corp.*, 136 F. (2d) 231, *cert. den.* 320 U. S. 751, did not involve this question. The transactions in that case were trading transactions of "purchase and sale" within the language of the statute.

[4] "Preferred stocks with the conversion privilege are frequent in the modern financing of corporations, the conditions of their conversion varying widely in different corporations" (Conyngton, Corporation Procedure, Rev. Ed. 1927, p. 374). Moody's Manual of Investments—Industrial Securities, 1946, at pages A83-4, lists 370 publicly held industrial convertible stock issues outstanding as at that time. Included in these issues are convertible preferred stocks of many of the leading companies in the United States.

to such a transaction as the one at bar, is constitutional. The Circuit Court of Appeals disposed of this question by saying merely that it "is entirely without merit; indeed it is foreclosed by *Smolowe* v. *Delendo Corp.*"[5] However, the *Smolowe* case involved no such situation as is here presented.

II

The Court below has decided Federal questions in a way probably in conflict with the applicable law, and has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

A. The conversion of preferred stock into common is not a "purchase" within the language of §16(b).

The word "purchase" in ordinary usage does not include a conversion. "Purchase" involves acquisition of an interest not theretofore owned, while "conversion" involves only a change of an existing interest into another form. To use a homely illustration, one may either *purchase* a garage or he may *convert* his barn into one.

It is very artificial to say that either party to the conversion of a convertible security is making a purchase from, or a sale to, the other. We have been able to find no instance, nor has any been cited by the parties, or the courts below, in which legislators or corporate draftsmen have heretofore so characterized either side of this type of transaction. It is commonly recognized in corporate legislation that when a convertible security is authorized, that carries with it, *eo ipso*, authorization for issuance

[5] 160 F. (2d) at p. 988; R. 120.

of the security into which it is convertible.[6] Where stockholders owning convertible preferred stock exercise their conversion privilege, there is no stock transfer tax on the surrender of the preferred stock and no tax liability on the issue of the common stock if the capital of the corporation is not thereby increased.[7] In common parlance, too, and in standard corporate draftsmanship, the words "purchase" and "conversion" are used to denote, respectively, separate types of transactions, differing from each other in the sense which we have indicated. The Securities Exchange Act was devised to regulate the conduct of business men in the securities field, and its language should be construed "as the average business man would read and understand it. He is the one who must bear the burden civilly and criminally."[8]

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[6] The Maryland statute, for example, so declares (Md. Ann. Code, Art. 23, Sec. 45(5)). The New York Stock Corporation Law provides that, in case the authorized capital is not sufficient to meet all conversion requirements, the directors may file a certificate of increase without further action by the stockholders (N. Y. Stock Corp. Law, Sec. 16). Statutory provisions in other states require that the corporation retain in its treasury from the date of issuance of the convertible security a sufficient number of shares of the stock into which it is convertible to meet the possible exercise of the outstanding conversion rights (e. g., Compiled Laws Mich. 1929, Section 10002).

[7] Treasury Department, Special Ruling of Internal Revenue Bureau, July 25, 1941 (CCH Federal Tax Service, 1941, Volume 3, ¶6466, Page 8237).

[8] *Randall* v. *Bailey*, 288 N. Y. 280, 287.

B. The meaning of "purchase" in §16(b) is not enlarged by §3(a)(13) of the statute so as to include the transaction at bar.

The Circuit Court of Appeals recognized that it was doubtful whether the word "purchase" in its normal significance would include a conversion, but reasoned as follows (160 F. (2d), at p. 987; R. 119):

> "Whatever doubt might otherwise exist as to whether a conversion is a 'purchase' is dispelled by definition of 'purchase' to include 'any contract to buy, purchase, or otherwise acquire.' §3(a) (13). Defendants did not own the common stock in question before they exercised their option to convert; they did afterward. Therefore they acquired the stock, within the meaning of the Act."

However, the question is not whether a party has "acquired" the stock, but whether he has acquired it by those means which alone are specified in the statute. If it can be held, as was done by the Circuit Court of Appeals, that the petitioners "acquired the stock, within the meaning of the Act" because they did not own it before conversion but did afterward, then it would be equally logical to hold, in the case of one inheriting stock, or getting it by gift, that he "acquired the stock, within the meaning of the Act" because he did not own it before, but did own it afterward.

§3(a)(13) does not support this result. In so far as §3(a)(13) defines "purchase" to include "any contract to buy, purchase," it does not modify the meaning of the word "purchase" in §16(b), since both sections speak solely, up to this point, of "purchase." Consequently, if §3(a)(13) is to be said to work any enlargement of the meaning of the word "purchase" in §16(b), this can occur only because of the additional words "or otherwise acquire." But these additional words are governed by

the word "contract", and the only "contract to * * * otherwise acquire" in the case at bar was the contract right to convert which went with the preferred stock when the petitioners bought it in 1937. In January, 1944, when the petitioners converted, they did not enter into any "contract to * * * otherwise acquire," but made their acquisition by the exercise of a right which had become theirs back in 1937. The Circuit Court of Appeals, in order to apply §3(a)(13) to the case at bar, read the words "or otherwise acquire" as though the word "contract" were not in the section at all; or, to put it in another way, as though §3(a)(13) defined "purchase" to "include any contract to buy *or* purchase, *or any acquisition however accomplished.*"

Such a construction of §3(a)(13) also violates the Congressional intent in the enactment of the section. It is common ground that, as was argued by the SEC in its brief in the Circuit Court of Appeals, "one of the evils primarily aimed at in this statute was the use of the securities option device to facilitate improper market practices." The SEC, after citing Sen. Rep. No. 1455, 73rd Cong. 2nd Sess., pp. 55-63 as authority for the foregoing statement, continued: "As the House Report emphasized: 'The granting of options to pools and syndicates has been found to be at the bottom of most manipulative operations, because the granting of these options permits large-scale manipulations to be conducted with a minimum of financial risk to the manipulators.' H. Rep. No. 1383, 73rd Cong., 2nd Sess. pp. 10-11."

In the above sense §3(a)(13) serves a salutary purpose, in that it militates against the use of executory contracts (for example, options, puts, calls) as devices to escape the operation of the Act. However, the conversion of a convertible preferred stock has no resemblance to a "securities option device." A different question would arise, coming within §3(a)(13), where a defendant purchased the convertible preferred, exercised his contract

right to convert it into common, and sold the common, all within a period of six months' time. But it is fanciful to speak of transactions involving the bona fide purchase of securities and their retention over a period of years at the normal risk attending any investment, as coming within devices which permit "large-scale manipulations with a minimum of financial risk to the manipulators."

C. It was not the intention of Congress, in enacting §16(b), to include transactions like the one at bar within the operation of the section.

Construing §16(b), the Court said in *Smolowe* v. *Delendo*:[9] "We look first to the background of the statute. Prior to the passage of the Securities Exchange Act, speculation by insiders—directors, officers, and principal stockholders—in the securities of their corporation was a widely condemned evil." It was to correct this evil that §16(b) was enacted.

The same position was taken in this Court by the United States in *Smolowe* v. *Delendo*, when it said, in its Memorandum in opposition to the application for certiorari, that "Section 16(b) creates in any issuer with equity securities registered under the Act, and in its security holders, the right to recover from officers, directors, or 10% stockholders—in short, 'insiders'—any profits which the insiders may make by trading operations in such equity securities within a period of six months."

The "speculation" of which the Circuit Court of Appeals spoke, and the "trading operations" of which the United States spoke, received precise definition in the provision of §16(b) for accountability for profits realized by insiders "from any purchase and sale, or any sale and purchase, of any equity security of such issuer" within six months. The typical case of abuse of inside informa-

[9] 136 F. (2d) at p. 235; see also footnote 1 at that page.

tion, which §16(b) was devised to reach, was the taking of a long or short position in the security of his company by an officer or director, upon learning from inside sources of some favorable or unfavorable development before the general public could learn about it. The officer or director thereupon bought or sold stock of the corporation, as the case might be, and then covered the transaction when the market reacted to the news of which he had had advance information. If he went long on the stock because the news was favorable, he made the "purchase and sale" of which §16(b) speaks. If he went short of the stock because he had learned of an unfavorable development, he made the "sale and purchase" of which the section speaks. In either case the insider took two steps which, together, comprised the "speculation" or "trading operations" at which the statute was aimed: he first took a position in the company's stock, and then withdrew from it. This is the swing which the statute was intended to reach. It begins when the stock is bought, or is sold short, or when a commitment to do either of the foregoing is made, and it terminates when the transaction is closed out by a sale or "covered" by a purchase.

The exercise of the election to convert a security, owned for a long time before by the stockholder, does not come within the evil at which the statute is aimed. The purchase of a convertible stock represents a prudent hedge against changing financial conditions. A preferred stock convertible into common gets its value in large part from the fact that in times of high commodity prices, or inflation, the stockholder can protect himself by exercising his right of conversion. This is not the kind of transaction at which §16(b) was aimed.

D. The petitioners' acquisition of the common stock, even if otherwise within the statute, was "in good faith in connection with a debt previously contracted," and thus is specifically exempted from the operation of §16(b).

The purchaser of shares of convertible preferred stock obtains, by virtue of the provisions of the certificate of incorporation pursuant to which such stock is authorized and issued, in addition to a stock interest, a contract right to receive the common stock into which his preferred shares are convertible; and breach of this right is compensable in damages.[10] The existence of this contract right was expressly found in the case at bar.[11]

In *Pierce* v. *United States*[12] the court said: "In a broad sense a debt may signify any duty to respond to another in money, labor, or service."

This Court spoke in the same sense in *Miller* v. *Robertson*, as follows:[13]

> "The meaning of the word 'debt,' as used in many statutes, is not restricted to demands enforceable in actions of debt. Lord Coke, referring to the Statute of Merton (A. D. 1235), said (Institutes, vol. 2, page 89): 'Debitum signifieth not only debt, for which an action of debt doth lie, but here in this ancient act of Parliament, it signifieth generally any duty to be yielded or paid * * *' ".

In the above case this Court cited, with approval, *New Jersey Insurance Co.* v. *Meeker*, 37 N. J. L. 282, 301, where the court defined "debt" as a word "of large import, including not only debts of record and judgment, and debts by specialty, but also obligations arising on an

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[10] *Cheatham* v. *Wheeling and L. E. R. Co.*, 37 F. (2d) 593.

[11] Finding V, R. 79.

[12] 257 Fed. 514, 516, C. C. A. 8th, 1919; aff'd 255 U. S. 398.

[13] 266 U. S. 243, 249.

implied contract to a very wide extent, and in its popular sense includes all that is due to a man in any form of obligation or promise."

There is a wealth of judicial approval for the following:

> "In common parlance the word 'debt' is sometimes used to denote any kind of a just demand, and has been differently defined owing to the subject matter of the statutes in which it has been used; and while ordinarily it imports a sum of money arising upon a contract express or implied, in its most general sense it means that which one person is bound to pay or perform to another."[14]

In the case at bar the Circuit Court of Appeals said that the statutory exception "is clearly inapplicable to anything except transactions in connection with actual debts."[15]. The obligation of the respondent to issue 1¼ shares of common stock upon conversion of each share of preferred stock, at the election of the preferred stock-

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[14] Am. & Eng. Enc. of Law (2d Ed.) 983. In *Proctor-Gamble Co.* v. *Warren Cotton Oil Co.,* 180 Fed. 543, 546, the court approved the foregoing definition, as well as the following definition from the Standard Dictionary: "The obligation resting upon one person to pay or perform something that is due to another; the state or condition of being indebted to another." In *Gilman* v. *Commissioner,* 53 F. (2d) 47, 50, the court quotes with approval the definition in Webster's New International Dictionary that a debt is "that which is due from one person to another, whether money, goods or services; that which one person is bound to pay to another, or perform for his benefit." In *Latimer* v. *Veader,* 20 N. Y. App. Div. 418, 426, the court quotes with approval the definition of the word "debt" in the Imperial Dictionary as "that which is due from one person to another, whether money, goods or services; that which one person is bound to pay to or perform for another; that which one is obliged to do or suffer." In the last-mentioned case, the court points out further that "there are many cases in which this broader significance has been applied to the term." *Cf.* also, *Carver* v. *Braintree Manufacturing Company,* 2 Story 432, 448-50.

[15] 160 F. (2d) 987; R. 119.

holder, was as much an "actual debt" as the obligation to pay him the redemption price if he elected the alternative of redemption.

The Circuit Court of Appeals further said: "Ownership of preferred or common stock creates an equity interest, and not a creditor's interest, under these circumstances."[16] This, however, misses the point. The ownership of stock, *per se*, creates only an equitable interest; but when the stock is convertible by the terms of the certificate of incorporation into securities of another class, the right of conversion is a contract right which creates a "debt".

Under the construction given by the Circuit Court of Appeals to the exception in §16(b), the exception could come into operation only when the stock is received in payment or satisfaction of money owing. There is no warrant for such a limitation upon the meaning of "debt".

III

Section 16(b), if construed to include the transaction at bar, would be unconstitutional.

The contract right to convert one class of stock into another is of the essence of the relationship between the holder of the convertible stock and his company, and, commonly, is a major inducement for the purchase of the convertible security. It is no answer to say, as was argued below, that §16(b) does not deprive such a stockholder of his right of conversion, but only of his right to deal freely in the security received thereby. The constitutional mandate is not satisfied by destroying the substance and leaving the shadow.

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[16] 160 F. (2d) at p. 987; R. 119.

In *Smolowe* v. *Delendo Corp.*,[17] the Court held that Congress could constitutionally make insiders accountable for the profits of short swing speculations because there was ample evidence to support the Congressional finding that these transactions were an evil in interstate commerce, and because the remedy was reasonably adapted to the correction of that evil.

Short swing speculations by insiders, the Congress found, have no legitimate place in commerce. The same cannot be said, however, and Congress has never evidenced any intent to say it, of the widespread and highly useful institution of convertible corporate securities. There has been no showing made that either the existence or any known use of these conversion rights is in itself an evil, or contributes to the evils, at which the statute is aimed. There are lacking, in the case at bar, both the need for regulation, and the showing that the regulation imposed has a "real and substantial relation to the objects sought to be obtained."[18]

WHEREFORE, it is respectfully submitted that the writ of certiorari herein prayed should issue.

June, 1947.

ARTHUR D. SCHULTE, JOHN S. SCHULTE and DAVID A. SCHULTE, JR., as Trustees,
Petitioners,

By EDWIN A. FALK,
MURRAY C. BERNAYS,
Counsel for Petitioners.

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[17] 136 F. (2d) at pp. 239-41.

[18] *Nebbia* v. *New York*, 291 U. S. 502; *Biddle Purchasing Company* v. *Federal Trade Commission*, 96 F. (2d) 687, *cert. den.* 305 U. S. 634.

Appendix A

Section 27 of the Securities Exchange Act of 1934 (Title 15, U. S. C., §78aa), reads as follows:

> "The district courts of the United States, the district court of the United States for the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 225 and 347 of Title 28. No costs shall be assessed for or against the Commission in any proceeding under this chapter brought by or against it in the Supreme Court or such other courts."

Section 16 of the Securities Exchange Act of 1934 (15 U. S. C., §78p), so far as pertinent, reads as follows:

> "(a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security or within ten

days after he becomes such beneficial owner, director, or officer, a statement with the exchange (and a duplicate original thereof with the Commission) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been any change in such ownership during such month, shall file with the exchange a statement (and a duplicate original thereof with the Commission) indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

"(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

Section 3(a) subdivision 13 of the Securities Exchange Act of 1934 (section 78c(a), subdivision (13) of Title 15 U. S. C.) reads as follows:

> "The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire."

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HIRSON, BERTINI & ROTHENBERG,
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Statement.

The respondent, Park & Tilford, Inc. (plaintiff below) brought this action against the petitioners pursuant to § 16(b) of the Securities Exchange Act of 1934,[1] which

[1] The text of the statute appears in Appendix A of the petition and will not be repeated here.

renders principal stockholders, directors and officers liable to their corporation for any profit realized from the purchase and sale of the corporation's listed securities within any six months' period.

A principal stockholder is defined (§ 16(a) of the Act)[1] as the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange. At the times here involved the petitioners were the beneficial owners of more than 10 per centum of Park & Tilford's registered common stock and therefore subject to the liability imposed by § 16(b) (R. pp. 6, 53).

ARGUMENT.

POINT I.

The reasons relied on in the petition for granting the writ do not satisfy the requirements of General Rule XXXVIII(5) of this Court. No important questions of federal law have been decided requiring consideration by this Court.

§ 16(b) was enacted to curb the widely condemned evil of short-swing speculations by corporate insiders with advance information.[2] It was found that such activities affected the securities market to the detriment of the more numerous "outside" stockholders. Therefore, to redress the balance, the statute makes it unprofitable for insiders to capitalize on their advantageous position.

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[2] *Smolowe* v. *Delendo Corporation*, 2 Cir., 136 F. (2d) 231, 235; cert. den. 320 U. S. 751.

To prevent evasion of the Act, § 16(b) expressly provides that any profit realized within the proscribed period shall inure to the company irrespective of any intention on the part of the insider, when entering into the transaction, of holding the security purchased for a period exceeding six months. And for the same end, the scope of the word "purchase" was broadened by definition [3] so as to render ineffectual the use of manipulative devices to circumvent the statute. Consequently, "Bona fide transactions, too, may be caught in the net of the law. But what is legitimately struck at is the tendency to evil in other cases".[4]

Petitioners concede (p. 10) that § 3(a)(13) was adopted to prevent the use of the option device as an instrument of evasion. They argue however that a convertible security does not resemble an option, and as it serves a useful economic purpose to the prudent investor it should be immune from the application of the statute. The weakness in the argument is that petitioners are unable to show that a conversion privilege is essentially dissimilar from an option and that it is not capable of being used as a device to evade the Act.

The conversion privilege attached to preferred stock is an option.[5] Like any other stock option it confers upon the holder the right to call upon the company for a specified number of shares. Whether the exercise of the right must be accompanied by a cash payment, the surrender of preferred stock, or both, is of scant importance to the nature of the device sought to be reached by § 3(a)(13). It surely is not to be ascertained by reference to its market label.

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[3] § 3(a)(13) of the Act provides: "The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire."

[4] *Smolowe* v. *Delendo Corporation, supra,* at p. 240.

[5] *Cheatham* v. *Wheeling and L. E. R. Co.,* 37 F. (2d) 593, 596.

Nor may a device which answers the description of the section be used to defeat the remedial purpose of the Act because of the manner of its creation or the otherwise useful function it was intended to perform. Options are granted in numberless ways. For example, it may be attached to a particular class of stock, or separately granted to stockholders upon an increase of capital; it may be voted to a favored few, or given for services rendered. However obtained, the option can be used by the insider to acquire the listed security for a short-swing profit. The Act was designed to prevent the improper, not the ligitimate, use of the device. It is therefore no answer to say that convertible stock serves a legitimate purpose. So do the other forms of options alluded to. None has been forbidden or impaired as a lawful instrument of corporate practice.

Considered in the light of its purpose § 3(a)(13) must include any option device which can be used to evade the liability imposed by § 16(b). If an acquisition of stock, accomplished by exercise of the conversion option, were not deemed a purchase within the broad definition of § 3(a)(13), the Act would be rendered impotent.

However, as the parties are in accord as to the meaning and purpose of the sections of the Act under consideration, the question decided by the Circuit Court was not an important question of statutory construction meriting review by this Court. The case presented the narrow issue of the application of the Act to a particular transaction—a transaction that is indistinguishable from many others of the same category. It differs from the others, if at all, only in detail, not in kind.

POINT II.

The petitioners' acquisition of common stock upon conversion of the preferred constituted a purchase of such common stock within the meaning and intent of § 16(b).

A. "Purchase", as used in the Act, includes any voluntary acquisition of a listed security.

Petitioners contend that the conversion of preferred stock into common is not a "purchase" within the *language* of § 16(b). The supporting argument derives from an interpretation of the word "purchase" in its colloquial rather than statutory sense. Though "purchase" itself was not defined by the Act, § 3(a)(13), by enlarging its scope, discloses a clear intent that the word be given a broad, unrestricted meaning. Its full import must be sought from associated words and the declared purpose of the Act.[6]

"Purchase" ordinarily represents an executed transaction. In declaring that the word includes a contract to buy, purchase, or otherwise acquire, § 3(a)(13) has added the executory transaction as well. But in describing the kind of executory transactions that are included by "purchase", § 3(a)(13) is equally describing the kind of executed transactions which are embraced by the word. If Congress had intended, in the case of a present transaction, to restrict the application of the Act to a cash purchase, § 3(a)(13) would have added only its corresponding executory contract. Having added also the executory "contract to otherwise acquire", it is plain that in its executed phase

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[6] *Smolowe* v. *Delendo Corporation*, 2 Cir., 136 F. (2d) 231, 238, cert. den. 320 U. S. 751; *Helvering* v. *Hammel*, 311 U. S. 504, 510; *Burstein* v. *U. S. Lines Co.*, 2 Cir., 134 F. (2d) 89, 93.

"purchase" was meant to represent any form of acquisition. To adopt the petitioners' restricted construction of "purchase" one must assume that § 3(a)(13) arbitrarily included the executory contract to otherwise acquire, that is to say, a transaction entirely extraneous to the definition of "purchase". The assumption is not warranted.

"Purchase" is defined as the acquisition of property "by one's own act or agreement, as distinguished from the act or mere operation of law".[7] When used in a statute or regulation the word is given this broad definition.[8] Hence even as "purchase" includes any executory contract to otherwise acquire (*vide* § 3(a)(13)), so it normally represents any present acquisition, whether for cash or otherwise, and concededly the petitioners, as a result of their conversion, "otherwise acquired" the common stock.

Additional support for this view may be found in § 16(b) itself. The section excludes from its operation any security which "was acquired in good faith in connection with a debt previously contracted". It is clear, first of all, that "purchase" was used interchangeably with "acquisition". Second, by expressly excluding a security acquired otherwise than for cash, the section indicates that "purchase" was used in the broadly defined sense of any acquisition; conversely, if the word carried the sole meaning of a cash transaction it would not be necessary to exclude, in express terms, a different type of transaction. Finally, in specifying the particular acquisition which shall be exempted, § 16(b) by implication includes all other acquisitions.

Petitioners say that "purchase" involves the acquisition of a new interest while conversion involves only a change of an existing interest into another form. This

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[7] Funk & Wagnalls' New Standard Dictionary, 1940.
[8] *Johnston* v. *United States*, 9 Cir., 145 F. (2d) 137, 138.

distinction is more apparent than real and stems from the use of words without regard to their legal content. In electing to convert the petitioners exercised an option to acquire a new interest, common stock, and thereby changed their status with relation to the company from preferred stockholder to common stockholder. Though in a loose sense their conversion involved the change of an existing interest, it nevertheless involved the acquisition of the new common stock The point is that § 16(b) is not concerned with the means employed in accomplishing the acquisition (by the surrender of preferred stock rather than the payment of cash) but only with the acquisition itself.

The petitioners contend (p. 9) that if the Circuit Court's decision is sound it must follow that stock acquired by inheritance or gift is also within the compass of § 16(b), a result at variance with the statute's intent. The argument is predicated on a miscontruction of the opinion. We agree and it is implicit in the opinion that the acquisition must be a voluntary one; that § 16(b) may be invoked only when the fiduciary himself takes a position in the company's security. Here, the petitioners voluntarily elected to convert to get the advantage of the higher value enjoyed by the common stock.

Finally, petitioners assert that though § 3(a)(13) defines "purchase" as including any contract to otherwise acquire, in their case the contract to acquire the common stock was made in 1937 when the convertible preferred was purchased, whereas in January, 1944, when the conversion was effected, they entered into no contract to otherwise acquire. The inference is that since a greater period than six months separates the contract to otherwise acquire from the sale, the profit realized did not inure to the company. The argument is based on the erroneous assumption that once an

executory contract to purchase is made, the actual purchase thereafter occurring must be ignored in determining the six months' period embracing the purchase and sale. In effect their position is that in such event the date of the contract rather than the date of the purchase itself controls. Nothing in the statute supports this view. When a purchase is followed by a sale liability results regardless of the fact that the purchase had been preceded by a contract to purchase. The statute permits the corporation to select either act (the contract to purchase or the actual purchase) as the initial transaction in computing the six months' period. It would not be in consonance with the declared purpose of the Act to leave the choice with the fiduciary since it would be a simple matter to arrange a preliminary contract, even in the case of a cash purchase, and wait for a favorable time to consummate it.

B. The declared purpose of the Act requires that "purchase" be liberally construed so as to include any voluntary acquisition of a listed security.

We dare say the word "purchase" was deliberately left undefined in the statute for if specific transactions had been described as coming within its purview, the way would be left open for many ingenious forms of evasion. On the other hand, the word's accepted meaning in legal usage (as any acquisition) is broad enough to make the application of the statute to a particular transaction comparatively simple once the transaction is examined in the light of the declared purpose of the Act.

As the statute was enacted to curb a widespread evil, it is a distinction without a difference that a short-swing profit is made by means of an acquisition of stock through con-

version rather than for cash. Since Congress thought it necessary, in order to close an obvious avenue of evasion, to treat a contract to otherwise acquire as a purchase within the Act, it is not logical to say that a present acquisition was meant to be excluded. It needs little emphasis that a present acquisition is the more frequent, more usual transaction resorted to. Allowing the fiduciary to keep the profit in the one case and not in the other will surely destroy the effectiveness of the Act.

If an acquisition through conversion is entitled to exemption from the statute, then by the same token any stock that has been borrowed or acquired through an exchange for other stock should enjoy a like exemption. The petitioners, to be sure, do not make this contention as it finds no support in logic or reason. Yet in principle, one such acquisition should be as free from the condemnation envisaged by the Act as either of the others. It is plain therefore that if in the process of construction exceptions are allowed to creep into § 16(b) the attrition of the Act will have begun. Only the broadest definition of "purchase" can prevent its emasculation. By giving it the meaning of any acquisition, a meaning that is neither strained nor uncommon, the Circuit Court construed the word in harmony with the Act's intended purpose.

POINT III.

The petitioners' acquisition of the common stock was not exempted from the operation of § 16(b) as an acquisition "in good faith in connection with a debt previously contracted".

Petitioners maintain (pp. 13-15) that their acquisition of the common on conversion falls within the exemption contained in § 16(b). The argument is that their contract right

to convert imposed an obligation on the company to respond to a request for conversion and that such obligation was equivalent to a debt previously contracted. The argument was rejected in the Court below as a distortion of the phrase "a debt previously contracted". Read in its context the word "debt" has only the commonly accepted meaning of an indebtedness payable in money or kind.

That it was not used in the loose sense advocated by the petitioners can be seen from their own argument with respect to § 3(a)(13). The petitioners, it will be recalled, concede that § 3(a)(13) was designed to bring options within the scope of § 16(b). An option, precisely like a convertible right, imposes an obligation on the company to deliver stock upon request of the option holder. If a "debt previously contracted" represents the sort of obligation suggested by the petitioners, then by the same logic all options are exempted under the exception contained in § 16(b). It is obvious that the petitioners' construction of the word "debt" is entirely untenable.

Petitioners overlook an integral part of the exemption clause, namely, that the security was acquired "in good faith" in connection with the debt previously contracted. This phrase makes it unmistakably clear that when speaking of "debt" the statute is referring to an ordinary indebtedness. To constitute a "good faith" acquisition the creditor must show that he was faced with the alternative of not being able to collect the debt in cash. In short, the exemption deals with an involuntary acquisition, one that completely negates the presumption that the insider was taking a market position in his company's securities in order to capitalize on inside information.

The cases cited by the petitioners do not support their view. The obligation to convert is a duty rather than a

debt. It has been expressly held that "The liability of a corporation to its stockholders on account of their stock is not a debt".[9]

POINT IV.

§ 16(b), as applied to the defendants' acquisition of common stock upon conversion, is constitutional.

In challenging the constitutionality of the Act the petitioners advance the theory that as Congress sought only to curb short-swing speculations by insiders but did not intend to curtail the use of convertible securities, any attempted restriction upon the use of convertible stock has no real or substantial relation to the objects of the Act. The short answer to the argument is that the petitioners have misleadingly equated the evil of short-swing speculation by insiders with the means used to accomplish it.

§ 16(b) was not designed to eliminate the legitimate use of traditional corporate practices. Though § 3(a)(13) prevents the use of an option as a device to evade liability, it has not abolished or otherwise restricted it; nor has Congress denounced it as an evil in itself. So with the convertible security; it has a proper function to perform and when not used in contravention of § 16(b) is not subject to any restrictions. On the other hand, when used as a device to evade the Act, it is, like any other option, subject to the application of § 16(b).[10]

But the right to convert is not in the least affected by the statute—no more than is the right to purchase a security for cash. The Act is applied only when an acquisition is followed by a sale within six months.

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[9] *Eyster* v. *Centennial Board of Finance*, 94 U. S. 500, 502.
[10] *East New York Savings Bank* v. *Hahn*, 326 U. S. 230, 232.

Conclusion.

The petition for a writ of certiorari should be denied.

HIRSON, BERTINI & ROTHENBERG,
Attorneys for Respondent, Park & Tilford, Inc.

MAX L. ROTHENBERG,
MAX M. HIRSON,
Of Counsel.

Dated, July, 1947.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

No. 146

ARTHUR D. SCHULTE, JOHN S. SCHULTE and DAVID A. SCHULTE, JR., as Trustees under a trust agreement dated June 3, 1932, made by David A. Schulte, as Grantor,

Petitioners,

against

PARK & TILFORD, INC.,

Respondent,

UNITED STATES OF AMERICA,

Intervenor-Respondent,

MARJORIE D. KOGAN, on her own behalf and on behalf of all other stockholders of Park & Tilford, Inc., similarly situated, and in the right of Park & Tilford, Inc.,

Intervenor-Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR INTERVENOR-RESPONDENT MARJORIE D. KOGAN, IN OPPOSITION

NATHAN B. KOGAN,
Attorney for Intervenor-Respondent,
Marjorie D. Kogan.

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Intervenor-Respondent.

BRIEF FOR INTERVENOR-RESPONDENT MARJORIE D. KOGAN, IN OPPOSITION

This brief is submitted on behalf of intervenor-respondent, Marjorie D. Kogan, a minority stockholder of Park & Tilford, Inc., who by order of the circuit court of appeals was permitted to intervene as a party to the action on behalf of minority stockholders and in the right of Park & Tilford, Inc., because the "interests of minority stockholders were not adequately represented by existing parties to the action" (R. 121).

The record recites circumstances showing the identity of interests of the respondent, Park & Tilford, Inc., its counsel, the petitioners and their counsel and the control of respondent, its officers and directors by petitioners by reason of their ownership of more than a majority of Park & Tilford's voting common stock (R. 97-101).

Opinions Below
Jurisdiction
Questions Presented
Statute Involved

To avoid burdensome repetition, this brief will not include any of the matters covered by the brief to be submitted on behalf of the United States and the Securities & Exchange Commission, in opposition to the petition for a writ of certiorari, and reference is made to that brief for the statements concerning the Opinions Below, Jurisdiction, Questions Presented and Statute Involved*

POINT I

The facts conclusively demonstrate that the petitioners as insiders, abused their fiduciary position, acquired common stock, sold the same to an uninformed public, and profited in violation of the statute.

The brief submitted by the United States and the Securities & Exchange Commission demonstrates that the acquisition by conversion is a "purchase" within the express language of the statute.

However, beyond the narrow confines of the conversion itself, is the factual background for the conversion. The

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*Intervenor Kogan has read the page proof of the brief to be submitted on behalf of the United States and the Securities & Exchange Commission and concurs fully in all of the arguments presented therein.

factual background reveals fully the violation not only of the letter of Section 16(b) of the Securities Exchange Act of 1934 (48 Stat. 896, 15 U. S. C. 78 p. (b)), but also of the spirit and purpose of said statute.

Park & Tilford, Inc. is a Delaware corporation, whose common stock is registered on the New York Stock Exchange (R. 31).

David A. Schulte was and is the dominant figure in the affairs of Park & Tilford, Inc. (R. 23, 117, 121). Until April 9th, 1945, David A. Schulte was president and a member of Park & Tilford, Inc's. five man board of directors (R. 97, 117).

On June 3rd, 1932, David A. Schulte created a family trust under which his three sons, the petitioners Arthur D. Schulte, John S. Schulte and David A. Schulte were appointed trustees. Mr. Schulte vested the petitioners with majority control of the corporation, by an ownership of 66% of the voting common stock (R. 76, 97, 117).

"On November 30, 1943, there were 243,731 shares of Park & Tilford common stock outstanding. Of this amount, the public held 18,249 shares or 9%; Schulte owned 54,510 shares or 22% directly; the 1924 Corporation, controlled by Schulte, held 4,853 shares or 2%, and 165,119 shares or 67% were held by the David A. Schulte Trust (the petitioners) which Schulte created for his family and friends and whose trustees were his three sons. It is conceded that the Schulte interests, holding over 90% of the common stock, controlled Park & Tilford, Inc." In addition, the Schulte interests owned 99% of all the outstanding preferred stock, which was not listed on any exchange. At that time out of 6,929 shares of outstanding preferred stock, the petitioners held 6,604 shares and David A. Schulte held 274 shares. (*Matter of Ira Haupt & Co.*, Securities Exchange Act of 1934, SEC Release No. 3845, p. 4, Aug. 20th, 1946) (R. 145).

The petitioners elected and controlled the officers and directors of the corporation. The board of directors was elected by a single ballot cast by the petitioners, who voted their majority stock (R. 98).

In 1945, David A. Schulte became chairman of Park & Tilford's five man board of directors (R. 97).

Petitioner, Arthur D. Schulte is president of Park & Tilford and a member of its board of directors. Jerome A. Eisner, a director of the corporation, is a beneficiary of the Schulte Trust to the extent of $12,000 per year. He is a member of the law firm who represents the petitioners in this proceeding and who at the same time are and for many years were general counsel for the respondent Park & Tilford, Inc. (R. 98).

Another director, Pheifer, comptroller of Park & Tilford, is in the personal employ of David A. Schulte (R. 98).

The attorneys for the respondent Park & Tilford, Inc. in this action were retained by the five man board of directors at a meeting held on October 27th, 1944, attended and approved by David A. Schulte, Eisner and Pheifer (R. 99).

Among the other beneficiaries of the Schulte Trust are the wife of David A. Schulte, who receives therefrom $82,000.00 per year and the three sons, the petitioners, who receive at least $25,000 per year therefrom (R. 99).

On November 29th, 1943, the petitioner-controlled board of directors elected to redeem all the convertible preferred stock of Park & Tilford as of March 20, 1944 (R. 10-11, 34-35, 64).

Beginning in the latter part of 1943, and ending in May 1944, there was a spectacular rise in the common stock as the result of rumors of an impending liquor dividend by the company (R. 23, 118). On December 15th, Schulte

made a public announcement of a contemplated whiskey distribution by Park & Tilford to its shareholders. (*Matter of Ira Haupt & Co.*, Securities & Exchange Act of 1934, SEC Release No. 3845, pp. 4 and 5, Aug. 20th, 1946.)

While the rumors of the whiskey dividend were rife, on January 19th, 1944, the petitioners exercised their option to convert their 6,604 shares of preferred stock, into common stock at the rate of 1¼ shares of common stock for each share of preferred. By the conversion, the petitioners acquired 8,255 shares of the common stock (R. 8-9, 34, 79).

On the conversion date, the stipulated market price of the common stock was $58.25 per share or $480,853.75 for 8,255 shares, and the stipulated value of the preferred, including the right of conversion was $364,871.00 (R. 65, 80, 81).

Within six months after the acquisition of the common, the petitioners sold 8,255 shares of common stock along with some 30,000 additional common shares held by them (R. 6, 37, 55, 80). These 8,255 shares sold between $93 and $98 per share between May 6th and May 26th, 1944, for a total of $782,999.59 (R. 55).

When the liquor dividend was announced on or about June 1st, 1944, it turned out not to be in fact a dividend, but an offer to the stockholders to buy Park & Tilford Reserve whiskey, subject to Office of Price Administration limitations of negotiability, and the price of the common stock fell from a high of $98.25 on May 26, 1944, some $68 per share to a new low of $30 per share in June to the detriment of thousands of stockholders who had come in on the rise (R. 23, 48, 145, 146).

Thus, the insiders, David A. Schulte, his 1924 Corporation and the petitioners "unloaded" 93,000 shares of $1 per share common stock, at a profit of many millions of

dollars between December 15, 1943 to May 31, 1944, including the shares acquired on conversion of preferred, before the true nature of the "dividend" was revealed to the public. The petitioners retained enough of the common stock to maintain their control of Park & Tilford. As of May 31st, 1944, the petitioners' holdings were reduced to 115,344 shares or 53%, and Schulte owned 2,410 shares or 1% (R. 98). During this same period, the public's holdings were increased from 18,249 or 8% to 115,344 or 46% (*Matter of Ira Haupt, supra*).

The intervenor Marjorie D. Kogan purchased 50 shares of Park & Tilford common stock on the New York Stock Exchange on March 10th, 1944. (Petitioners' statement commencing at the foot of p. 3 of the petition to the effect that her stock was acquired on March 10th, 1945, is probably a typographical error). She sold 25 shares on April 28th, 1944. Since March 10th, 1944, she has been an owner of Park & Tilford common stock and since May 3rd, 1944, she has been a stockholder of record (*Kogan* v. *Schulte*, 61 F. Supp. 604, 5, S.D.N.Y.).

On April 28th, 1944, intervenor Marjorie D. Kogan, notified the corporation that Mr. Schulte in his own name and through others realized profits from purchases and sales of the stock of the corporation in violation of Section 16-b of the Securities & Exchange Act of 1934, and she demanded that action be brought against Mr. Schulte and the others involved with him to recover such profits (R. 99, 102).

On June 19th, 1944, as a result of that demand, David A. Schulte repaid some $264,827.57 (R. 100).

On September 12th, 1944, Kogan commenced action pursuant to Section 16(b) against David A. Schulte, John D. Pheifer, Jerome Eisner, 1924 Corporation and Park & Tilford, Inc. in the United States District Court, Southern District of New York (Civil 27-302). In that action she

alleged that the petitioners Schulte Trustees were a "dummy" of David A. Schulte.

On November 17th, 1944, the instant action was brought by Park & Tilford, Inc. pursuant to Section 16(b) of the Act, to recover profits realized by petitioners on the purchase and sale within six months of the 8,255 shares of common stock acquired by conversion on January 19th, 1944.

David A. Schulte converted his 274 shares of preferred stock on January 31st, 1944, and acquired 342½ shares of common stock, which he sold along with thousands of other shares on the high, within six months thereafter. This transaction was identical with the conversion by the petitioners of their 6,604 shares on January 19th, 1944.

On June 20th, 1945, the district court in the action entitled "Marjorie D. Kogan, suing in her own behalf and on behalf of all other stockholders of Park & Tilford, Inc. similarly situated, plaintiff, against, David A. Schulte, John D. Pheifer, Jerome Eisner, 1924 Corporation and Park & Tilford, Inc., defendants (Civil 27-302)" on a motion for partial summary judgment held, in an opinion reported at 61 F. Supp. 604, (1) that Mr. Schulte's acquisition of common stock upon conversion of preferred was a "purchase" within the meaning of Section 16(b); (2) that the acquisition did not come within the exception provided in Section 16(b) for securities acquired in good faith in connection with an antecedent debt; and (3) that Section 16(b) as applied to the transactions, was constitutional, citing *Smolowe* v. *Delendo,* 136 F. 2d 231, certiorari denied 320 U. S. 751.

On January 31st, 1946, the district court entered judgment herein after a trial, based on stipulations of counsel for the corporation and the petitioners, in the sum of $302,145.81, with interest from May 26th, 1944 (R. 83-84). The court in its memorandum opinion held that the peti-

tioners' acquisition by conversion was a "purchase" (R. 87); that the acquisition was not within the exception provided for good faith acquisitions in connection with an antecedent debt (R. 90); and that Section 16(b) as applied to such acquisition was constitutional (R. 90).

On appeal (in opinions reported at 160 F. 2d 984 and 989 (R. 116-121, 142-147), the circuit court of appeals affirmed the district court on the questions of statutory construction and constitutional validity of Section 16(b) which are here involved. The circuit court of appeals cited "as a reasoned opinion" *Kogan* v. *Schulte,* 61 F. Supp. 604, where identical questions were similarly decided (R. 118).

The circuit court of appeals disagreed with the district court only as to the amount of the recoverable profits, and held that the judgment should be increased to $418,128.59, because the district court had erroneously used the market price of the common stock as the "purchase price" of the common acquired on conversion, instead of the lower value of the preferred as stipulated by the parties and found by the trial judge (R. 120). The increase of damages was asked for by intervenor Kogan, who had been permitted to intervene on the appeal because of the "control" situation and the clear "inadequacy of representation" (R. 121).

Petitioners applied for a rehearing before the circuit court of appeals only with respect to the increase of the judgment and strangely enough, they were joined by the plaintiff-respondent Park & Tilford (R. 142-143)! Rehearing was denied, one judge dissenting, suggesting a new trial only with respect to the increased amount of the recovery (R. 142-147). The majority held that to do this, would require repudiation of the "rational and deliberate" stipulations of counsel as to value, and upon the facts denied the petition for rehearing.

Thus, we have nothing in this case but a purchase and sale of Park & Tilford common stock. The petitioners wanted to profit from an expected temporary rise in the market price of Park & Tilford. They knew the rise in the price was temporary because it was based on a false rumor. The question was how could they profit the most. They owned 6,604 shares of Park & Tilford preferred. As controlling stockholders, they could not publicly sell this block of Park & Tilford preferred because they would be obligated to register the offering and thereby be forced to disclose the truth. They could not sell the Park & Tilford preferred in small lots because it was not listed on any securities exchange and there was no ready market for the preferred (R. 145). They could not exchange and sell the Park & Tilford common in a block because that would again require registration and disclosure. To profit, they could only convert the preferred stock, thereby acquire the common stock, and gradually unload the common stock on the public at higher prices inflated by the false rumors.

Clearly if this is not a purchase and sale, then the statute is for naught. The petitioners used their inside position and knowledge to make a "short swing" profit. If such a transaction is exempted the way will be clear for insiders to profit. Thus a director need only own convertible preferred stock to profit from his inside information. On the eve of a favorable development of which the director has inside knowledge, the director can convert this preferred stock, acquire the speculative common stock, sell the common stock within six months thereafter, and realize a profit at the expense of the uninformed public. A convertible security will become a license to escape 16(b). Especially so, as in the instant case, where the convertible security had no public distribution, and was practically all owned by the insiders who had exclusive knowledge of the benefits to be realized by conversion.

The judgment below does not include all of the Schulte profits. Many millions of dollars of Schulte profits in Park & Tilford stock are beyond the scope of the statute. The $264,827.57 repaid to the corporation by David A. Schulte and the $418,128.59 judgment below against the Schulte Trustees aggregates $682,956.16. This is but a small fraction of the millions of dollars realized by the Schulte interests in Park & Tilford stock and is only about 10% of the decline of $68 a share on the 93,000 shares which the Schulte interests unloaded on the public. In the one month from May 1944 to June 1944 the market price of the additional 93,000 shares declined (in an otherwise rising market) from $98 per share to $30 per share, or a loss of $6,324,000 in the market value of said stock. It is not without significance that Mr. David A. Schulte has recently been in the process of reacquiring the stock and as of May 1947 again owned 10,810 shares of Park & Tilford common.

The court below has not decided federal questions in conflict with applicable law. On the contrary, the decision below is correct and in accord with existing decisions involving the same questions.*

There is no conflict of decisions either in the circuit court of appeals or with applicable decisions of the Supreme Court, involved in this case.

On the contrary there is complete unanimity both in the district court and the circuit court of appeals as to the true intent and meaning of the statute. Two district court judges in two separate cases, and three circuit court of appeals judges in well-reasoned opinions, have unani-

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* *Smolowe* v. *Delendo Corp.*, 2 Cir. 136 F. 2d 231, 148 A.L.R. 300, certiorari denied, 320 U. S. 751. *Kogan* v. *Schulte*, 61 F. Supp. 604 D. C. S. D. N. Y. *Madden* v. *Commissioner of Corporations and Taxations*, 280 Mass. 321, 323, 182 N. E. 480 (1932), where an acquisition of stock through the surrender of rights was held to be a purchase.

mously construed Section 16(b) of the Securities Exchange Act of 1934 to include as a "purchase" an acquisition of common by conversion of preferred stock; have held that no "debt" is involved, and have upheld the constitutionality of the statute.

There is no confusion as to leave doubt as to the true intent, meaning and constitutionality of the statute, as applied to the facts at bar. There are no other cases involving similar questions pending in the lower federal courts.

CONCLUSION

The petition for a writ of certiorari should be denied.

July 31, 1947.

Respectfully submitted,

NATHAN B. KOGAN,
Attorney for Intervenor-Respondent,
Marjorie D. Kogan.

INDEX

CITATIONS

754712—47——1

In the Supreme Court of the United States

OCTOBER TERM, 1947

No. 146

ARTHUR D. SCHULTE, JOHN S. SCHULTE AND DAVID A. SCHULTE, JR., AS TRUSTEES UNDER A TRUST AGREEMENT DATED JUNE 3, 1932, MADE BY DAVID A. SCHULTE, AS GRANTOR, PETITIONERS

v.

PARK & TILFORD, INC.

UNITED STATES OF AMERICA, INTERVENOR

MARJORIE D. KOGAN, ON HER OWN BEHALF AND ON BEHALF OF ALL OTHER STOCKHOLDERS OF PARK & TILFORD, INC. SIMILARLY SITUATED, AND IN THE RIGHT OF PARK & TILFORD, INC., INTERVENOR

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES, INTERVENOR, AND THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE, IN OPPOSITION

The United States intervened below because the constitutionality of Section 16 (b) of the Securities Exchange Act of 1934 (48 Stat. 896,

15 U. S. C. 78p (b)) as applied to the transactions here involved was drawn in question by the petitioners (R. 16–20). The Securities and Exchange Commission, which administers the Act, participated below as *amicus curiae* on the questions of construction of the Act raised in the proceedings. For the convenience of the Court, the views of both the United States and the Commission are here presented in a single brief.

OPINIONS BELOW

The memorandum opinion of the district court (R. 85–90) is not reported. The opinions of the circuit court of appeals (R. 116–121, 142–147) are reported at 160 F. 2d 984 and 989.

JURISDICTION

The judgment of the circuit court of appeals was entered on January 8, 1947 (R. 122), and rehearing was denied on March 26, 1947 (R. 148). The petition for a writ of certiorari was filed on June 21, 1947. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. 347) which is made applicable by Section 27 of the Securities Exchange Act of 1934 (15 U. S. C. 78aa).

QUESTIONS PRESENTED

1. Whether the acquisition of common stock upon conversion of preferred is a "purchase" of the common within the meaning of Section 16

(b) of the Securities Exchange Act of 1934 so that any profit realized by the sale within six months of such common stock is recoverable by the issuer under the section.

2. Whether common stock acquired upon conversion comes within the exception provided in Section 16 (b) for securities acquired in good faith in connection with an antecedent debt.

3. Whether Section 16 (b), as applied to the transactions involved here, is an improper exercise of Congressional power under the commerce clause of the Constitution and involves a denial of due process of law.

STATUTE INVOLVED

Section 16 (b) of the Securities Exchange Act of 1934 (48 Stat. 896, 15 U. S. C. 78p (b)) provides:

> For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner,[1] director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security)

[1] The term "such beneficial owner," as here used, refers back to the phrase in Section 16 (a): "Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange." The term "equity security" is defined in Section 3 (a) (11) of the Act as meaning, among other things, "any stock or similar security."

within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this this subsection.

STATEMENT

The action which resulted in the judgment sought to be reviewed was instituted by Park & Tilford, Inc. on November 17, 1944, pursuant

to Section 16 (b) of the Act, to recover profits realized by petitioners on the purchase and sale within six months of 8,255 shares of common stock of Park & Tilford. This stock was registered on the New York Stock Exchange, a national securities exchange (R. 5). Petitioners, trustees under a family trust, were subject to the provisions of Section 16 (b) as beneficial owners of more than 10% of the common stock of Park & Tilford (R. 8, 33–34, 53, 79, 86). In fact, petitioners controlled the corporation through ownership of a majority of its common voting stock and also owned a majority of the convertible preferred stock of the corporation (R. 76, 98, 145). The settlor of the trust, their father, was a former president of Park & Tilford, and in 1945 chairman of its board of directors. One of the petitioners was also a member of the corporation's board (R. 97–98).

On January 19, 1944, the petitioners exercised their privilege to convert 6,604 shares of the preferred stock, which they had acquired in 1937, into common stock in the ratio of 1¼ shares of common stock for each share of preferred, as provided in the certificate of incorporation. They thus acquired the 8,255 shares of the common stock in question on that date (R. 8–9, 34, 79).[2]

[2] About two months prior to the conversion, Park & Tilford's board of directors had decided to redeem, as of March 20, 1944, all the outstanding preferred stock ($50 par value) at $55 per share plus accrued dividends, if any, to the redemp-

It appears that beginning late in 1943 and ending in May, 1944, there was a spectacular rise in the market price of Park & Tilford common stock as a result of rumors of an impending liquor dividend by the company (see R. 23, 118). It was during this rising market that the petitioners elected to exercise their privilege to convert their preferred stock into common. On the conversion date, January 19, 1944, the stipulated market price of the common stock was $58.25 per share or $480,853.75 for 8,255 shares (R. 6–7, 81). Within six months thereafter, when much higher prices were reached, the petitioners sold 8,255 shares of common stock along with some 30,000 additional common shares held by them (R. 6, 37, 55, 80).

The highest prices at which 8,255 shares of such common stock were sold ranged between $93 and $98 per share between May 6 and May 26, 1944, for a total of $782,999.59 (R. 55).[3] The $302,145.81 profit claimed (R. 33, fol. 97) by Park & Tilford from the petitioners was the difference between this total and the stipulated market value of the 8,255 shares of common stock at the time of conversion (the purchase) (R. 55,

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tion date. Formal notice of the redemption call was given on December 20, 1943. The conversion privilege was exercisable at any time prior to the redemption date (R. 10–11, 34–35, 64).

[3] The record indicates that thereafter when the exact nature of the liquor distribution was made known to the public, the market price of the common fell precipitately (see R. 23, 145–146).

56, 61), pursuant to the rule for computing profits in Section 16 (b) cases—"lowest price in, highest price out"—enunciated in *Smolowe* v. *Delendo Corp.*, 136 F. 2d 231, 239 (C. C. A. 2), certiorari denied, 320 U. S. 751.

On January 31, 1946, the district court entered judgment in favor of Park & Tilford against petitioners in the sum of $302,145.81, with interest from May 26, 1944 (R. 83–84). The court held that petitioners' acquisition of common stock by conversion was a "purchase" of the common within the meaning of Section 16 (b) of the Act (R. 87). The court rejected petitioners' contention that the acquisition by conversion was within the exception provided in Section 16 (b) for good faith acquisitions in connection with an antecedent debt (R. 90). Finally, the court held that Section 16 (b) as applied to such acquisitions was constitutional (R. 90).[4]

On appeal, the circuit court of appeals accepted the conclusions of the district court on the questions of validity and construction of Section 16 (b) set forth above. However, it disagreed as to the measure of recovery, concluding that the amount of the judgment was too small. This re-examination of the question of damages was prompted by the contentions of Marjorie D.

[4] The same conclusions were reached in *Kogan* v. *Schulte*, 61 F. Supp. 604 (S. D. N. Y.) a separate action brought by Kogan, an intervenor herein (R. 87–88, 119).

Kogan, a minority stockholder of Park & Tilford, who had been permitted to intervene on the appeal because of the corporation's inadequate representation of minority stockholders (R. 121). The court recomputed the recoverable profit at $418,128.59 on the ground that the "purchase" price of the common was not the market value of the common acquired on conversion, but rather the lower market value of the preferred on the conversion date as stipulated by the parties and found by the district judge (R. 120). Accordingly, on January 8, 1947, the circuit court of appeals vacated the judgment and remanded the action to the district court for the award of a judgment for $418,128.59 with interest and costs (R. 122).

A petition for rehearing relating solely to the increase in the amount of the judgment was denied, one judge dissenting (R. 142–147). The petition for a writ of certiorari does not request review on the issue of damages.

ARGUMENT

Generally speaking the Securities Exchange Act of 1934 is designed to insure a fair and honest market which will reflect an evaluation of securities in the light of all available and pertinent data. Section 16 (b) implements this general purpose by making it unprofitable for insiders to engage in short-swing speculations on the basis of advance information available to them but not

known to "outside" stockholders and the investing public. The preamble to the section states that it was enacted: "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer * * *"

Liability under the section is based upon the profit realized by insiders from "any purchase and sale, or any sale and purchase" within a six months period. The section carries no penal consequences for failure to comply with the standard of conduct defined in it (cf. Pet. 8). It merely attempts to guard against the use of inside information by such persons by requiring the restoration to the company of any profit realized through "in and out" trading within the statutory period.[5]

1. The coverage of the term "purchase" as used in Section 16 (b) of the Securities Exchange Act of 1934 must be determined in the light of the definition contained in Section 3 (a) (13) of the Act and the broad remedial purpose of the statute, rather than by reference to the meaning accorded to such term when used in other con-

[5] In order to effectuate the purpose of the section and to strike at the "tendency to evil", Congress established an objective measure of proof under the section, thus making it unnecessary to show an actual misuse of inside information in a particular case. *Smolowe* v. *Delendo Corp.*, 136 F. 2d 231, 239 (C. C. A. 2), certiorari denied, 320 U. S. 751.

texts (see Pet. 7–8). Section 3 (a) (13) of the Act defines the term "purchase" to "*include* any contract to * * * purchase, *or otherwise acquire*" [italics supplied]. Clearly, this definition comprehends not only an unexecuted contract to purchase or otherwise acquire a security, but also an executed contract of purchase or other acquisition, whether for cash or otherwise.

The term "purchase" in its ordinary signification refers to the executed transaction of purchase. No further definition would have been required in the statute had not the Congress intended to broaden the meaning of the term to include both executory and executed transactions. Obviously, it was not intended to designate as a purchase executory contracts to acquire and exclude the much more important executed transactions. Moreover petitioner's argument deprives the word "include" of any significance.

While the thesis urged by the petitioners admits that the definition embraces executed transactions of purchase in the conventional sense, they deny its applicability to other types of executed acquisitions of securities. We believe this construction is plainly erroneous and that, with one exception specified in the statute,[6] Section 16

[6] At p. 12, *infra*, we discuss the exception contained in Section 16 (b) for securities acquired in good faith in payment of an antecedent debt. It would have been unnecessary to provide a specific exclusion for such acquisitions if the term "purchase" were restricted to conventional cash transactions.

(b) was clearly meant to include any mode of acquiring a security for consideration which is not exempted by the Commission under the section "as not comprehended within its purpose."

Accordingly, since the acquisition here involved is plainly a "purchase" under the statute, it is immaterial whether, as petitioners argue (Pet. 10), the 1937 acquisition of convertible preferred stock should also be considered as a purchase of the common stock on the theory that it contained a contract to acquire such common stock. To regard this 1937 transaction as a contract to acquire common stock, and thus a "purchase", in no way proves that the 1944 transaction by which the petitioners actually acquired the common stock upon conversion was not also a "purchase" of the common stock within the meaning of the Act.

Reference to the intent of the Congress lends no support to the position urged by the petitioners, but rather the contrary; their construction would render the section largely ineffective to discourage short term insider trading. The exercise of a conversion privilege can be as much a vehicle for the misuse of inside information as any other transaction of purchase. Under the petitioners' construction insiders could with a minimum of risk acquire senior securities with conversion privileges, and at the opportune time capitalize on inside information by converting into more volatile

junior securities and then selling out for a quick profit just before the market drops. The facts involved in the present case (*supra,* pp. 5–6) illustrate plainly the possibilities for capitalizing on the insiders' strategic position in such situations and demonstrate that they cannot be taken outside the scope of the statute without doing violence to its purpose.

2. The court below correctly held that an acquisition of securities upon conversion is not within the exception provided in Section 16 (b) for securities "acquired in good faith in connection with a debt previously contracted." This exception is clearly inapplicable to any transactions other than those in connection with actual debts. As stated by the court below (R. 119), "It is a strained concept, indeed, to regard preferred stock convertible into common as a debt here."[7] We believe that the statutory exception was intended to deal with the situation where an ordinary pre-existing cash debt is satisfied in whole or in part by the transfer of securities because the creditor believes in good faith that it is not feasible to insist on payment in cash. It is evident that Congress considered that this kind of transaction was so far removed from

[7] See *In re Phoenix Hotel Co. of Lexington, Ky.*, 83 F. 2d 724, 727, 728 (C. C. A. 6, 1936), certiorari denied, *Security Trust Co.* v. *Baker*, 299 U. S. 568. See also Section 3 (a) (11) of the Securities Exchange Act of 1934, 15 U. S. C. 78c (a) (11).

the evil sought to be remedied as to be specifically exempted in the statute.[8]

Petitioners concede that as stockholders they were not creditors of Park & Tilford (Pet. 15). They contend, however, that they were creditors because they owned an additional contractual conversion right, and that breach of this right is compensable in damages (Pet. 13). This argument overlooks the fact that no debt would arise until there was a breach of the conversion right and damage resulted and, of course, the statutory reference is to pre-existing debts. See *Cheatham* v. *Wheeling & L. E. Ry. Co.*, 37 F. 2d 593 (S. D. N. Y. 1930). It is clear that whatever the relationship of the petitioners to Park & Tilford might have been had the company refused to convert, that situation does not obtain in this case.

The petitioners' broad construction of the term "debt" to include the obligation to deliver stock pursuant to a contractual right (Pet. 13–15) would result in the exclusion from the operation of the section of acquisitions upon the exercise of option warrants. Such a construction would open a door to manipulative practices expressly

[8] Other kinds of transactions which might be found to be appropriate for exemption were left to the exemptive rule-making authority of the Commission if it should conclude that such transactions are not comprehended within the purposes of Section 16 (b). Petitioners do not contend that acquisitions upon conversion are within any of the exemptive rules promulgated by the Commission.

condemned by the Congress. S. Rep. No. 1455, 73d Cong., 2d Sess., pp. 55–63. Indeed, the petitioners appear to admit the undesirability of excluding option warrants from the section (Pet. 10).

3. There is no merit in the argument of the petitioners that the statute, as applied to the situation at bar, is unconstitutional. In *Smolowe* v. *Delendo Corp.*, 136 F. 2d 231 (C. C. A. 2), certiorari denied, 320 U. S. 751, it was held that Section 16 (b), even as applied to private transactions, is a proper exercise of Congressional power under the commerce clause of the Constitution and that the statute so interpreted does not infringe due process guaranties. The principles there applied are equally dispositive of the issues now raised by the petitioners.[9]

(a) The remedy provided in Section 16 (b) is operative only with respect to securities registered on a national securities exchange. There

[9]As stated previously, petitioners do not raise any question as to the correctness of the interpretation of the record upon which the majority of the Court below computed the amount required to be added to the judgment of the District Court, in order to reflect the cost of the Park & Tilford common stock acquired by petitioners upon conversion of the preferred stock. That question appears to turn in part upon a question of practice as to the circumstances under which a stipulation in open court may be repudiated and in part upon a factual analysis peculiar to the instant case. Irrespective of the correctness of this ruling, upon which the court below divided, the constitutional issue presented appears to be no different from that involved in *Smolowe* v. *Delendo Corp.* cited in the text.

can be no doubt that transactions on such exchanges may be regulated under the commerce clause of the Constitution. *Electric Bond & Share Co.* v. *Securities and Exchange Commission,* 303 U. S. 419, 440. Private transactions in listed securities are likewise subject to Congressional regulation since they "affect stock quotations on national security exchanges—and thus interstate commerce." *Smolowe* v. *Delendo Corp.,* 136 F. 2d 231, 240 (C. C. A. 2), certiorari denied, 320 U. S. 751; *cf. North American Company* v. *Securities and Exchange Commission,* 327 U. S. 686. The acquisition of common stock upon exercise of a conversion privilege affects quotations in that stock no less than the private transactions involved in the *Smolowe* case.

Section 16 (b) read in the light of the findings in Section 2 of the Act (15 U. S. S. 78b),[10] is a declaration by the Congress that all short-swing trading by insiders in securities listed on national securities exchanges affects interstate commerce, regardless of whether the transactions are them-

[10] "Sec. 2. * * * transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto, including transactions by officers, directors, and principal security holders, * * * to impose requirements necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce * * * and to insure the maintenance of fair and honest markets in such transactions * * *."

selves carried on in interstate commerce. This determination is plainly reasonable and should not be disturbed by the courts. *United States* v. *Darby,* 312 U. S. 100, 120–121.

In any event, Section 16 (b) does not purport to attach civil liability to the purchase transaction alone, but only to such transaction when coupled with a sale within six months. Petitioners do not contend that their sales of the common stock acquired on conversion were intrastate transactions. Therefore, if their sales of common stock are within the commerce power, even assuming that the conversion alone is not, there can be no doubt that Section 16 (b), as applied to these transactions, is a legitimate exercise of the Congressional power.

(b) Section 16 (b), as construed by the court below, involves no want of due process of law. The section was adopted by the Congress only after an extensive investigation and upon a considered finding of the abuses of inside speculation. As a device to deter insiders from speculating in their knowledge of their corporation's affairs, the section is but a reasonable adaptation of common law principles which have long been accepted by the courts in comparable situations. *Cf. Woods* v. *City National Bank,* 312 U. S. 262; *Meinhard* v. *Salmon,* 249 N. Y. 458, 164 N. E. 545. As pointed out in *Smolowe* v. *Delendo Corp.,* 132 F. 2d 231, 239 (C. C. A. 2), certiorari denied, 320 U. S. 751, the section is a reasonable legis-

lative restriction upon the evil sought to be prevented.

The petitioners contend, however (Pet. 16), that if Section 16 (b) is applied to an acquisition of stock upon conversion, it would not bear a reasonable relationship to the object sought to be accomplished. There has been no showing, they argue, that the use of the conversion privilege can contribute to the evils sought to be remedied by the section. Apart from the broad nature of the Congressional findings underlying the enactment, we submit that the facts involved in this very case demonstrate plainly that the "tendency to evil" at which the statute strikes inheres in a conversion situation (see *supra,* pp. 5–6, 11–12).

Nor is there any question, as petitioners suggest, of impairment of vested conversion rights (Pet. 15). As we have indicated, the section does not prohibit acquisitions upon conversion; its impact is only upon the "short-swing" resulting, in this case, from the subsequent sale of the securities so acquired at a profit within the specified period. Moreover, the convertible securities were issued and acquired by the petitioners after the passage of the Act. In any event, there can be no question as to the power of Congress in the regulation of interstate commerce to condition the exercise of preexisting contract rights. *Continental Ill. Natl. Bank & Trust Co.* v. *Chicago, R. I., & P. R. Co.,* 294 U. S. 648, 680.

CONCLUSION

The decision below is correct, and there is no conflict of decisions. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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